Elena Monica SABĂU
Cleopatra ŞENDROIU
Florinel Marian SGÂRDEA
Bucharest Academy of Economic Studies
emsabau@gmail.com

CORPORATE ANTI-FRAUD STRATEGIES – ETHIC CULTURE AND OCCUPATIONAL INTEGRITY

Case study

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JEL Classification
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Abstract

Anti-fraud strategy development in organization has a positive impact, by reducing the probability of occurrence, detection time and materiality for fraud, however protecting corporate reputation, brand, management credibility, and business itself.

Involving accounting profession in corporate governance processes, to ensure compliance, to present a true and fair view for the financial statements, to minimize risks, including the fraud one, involves assigning new responsibilities and expanding its area of deployment for the assurance engagement.

The article identifies the main anti-fraud strategy success drivers-work environment with high integrity, ethical organizational culture-being analyzed in terms of composition, development, implementation and qualitative analysis of efficiency and performance.

The main factor influencing the occurrence of fraud is the ethics culture and business integrity developed in the company. Its evaluation and its continuous improvement are the corporate governance requirements and prerequisites for the development of an uncorrupted occupational environment, with a proactive attitude in the fight against fraud. The final chapter summarizes the necessary documentation to be used in anti-fraud strategy development and implementation.

1. Need and Impact

Losses registered both by companies and employees can become pillars of the fraud triangle (pressure), increasing the risk of fraud in the organization. Legislative changes and the information environment creates an opportunity for fraud and *rationalization* is easy to find even for people with an average moral degree, cause to the present financial instability.

In those moments, people charged with governance in organizations need to integrate fraud risk issues, antifraud strategy deployment as a long-term solution for minimize costs.

Accounting profession has become increasingly involved in compliance processes regarding international standards, legal regulations and good practices for corporate governance success. Involvement of the accounting profession in corporate governance process, in ensuring compliance, in reporting a true and fair view of financial statements, involves new responsibilities assignment and widen deployment of assurance engagements.

The anti-fraud strategy primary purpose is to combat fraud in the sense of achieving maximum of internal controls for fraud prevention, deterrence and detection of potential offenders as much as soon as possible, in order to minimize the impact on the organization.

An anti-fraud strategy is more than internal controls application, it involves a clear statement of « zero tolerance » for fraud acts and a continuous monitoring of the organization's management, internal policies regarding ethics and integrity standards, good knowledge of the economic crime and fraud phenomenon within the organization, prevention, detection, investigation, response and reporting procedures.

2. Operational framework for anti-fraud strategy: objectives, planning and management

Anti-fraud strategy development involves an operational framework that is not limited to internal standards and procedures, or ethics codes (supporting only the theoretical principles of integrity). The steps required to be taken in order to develop and implement anti-fraud strategy are summarized in Figure 1.

In setting goals and planning the anti-fraud strategy development we will consider aspects of the so-called "anti-fraud program drivers" (Kovacick, 2008): legal regulations, the results of the fraud risk management, internal controls in place, procedures for prevention, detection.

Developing an anti-fraud strategy does not differ as a concept of any project, therefore having the same approach provided the projects management guidelines.

Team members will be organized within the structure of corresponding operational anti-fraud strategy and the steps needed to follow. A major information resource in this area - the matrix of responsibilities within the anti-fraud strategy - is provided by the IIA, AICPA and ACFE through practical guides published in 2012.

The aim of anti-fraud strategy development within the organization is prevention of fraud acts and fraud detection assisted by the response plans. Detecting fraud is very important but cannot be achieved without the prevention component and is obviously more cost effective - in terms of cost-benefit, fraud must be prevented or at least minimized to an acceptable level, rather than detected, when it involves subsequent damages.

Effective fraud prevention system development should be started from the results of specialized studies of organizations that have been affected by fraud.

The study conducted in 2010-2012 and published by the ACFE 2013, shows that the main weaknesses of the organizations that experienced fraud, were related to:

lack of internal controls 37.8%, 19.2% violation of internal controls, 17.9% lack of management review, incorrect tone on ethics 8.4%, inadequate staff in supervisory functions 6.9%, lack of independent external audit or other external examinations 5.6%, lack of education and anti-fraud training programs for employees 1.9 %, the lack of clear lines of authority 1.8%, lack of reporting mechanisms 0.6%, as shown in Figure 2.

Ways for achieving an integrated system to prevent fraud in the organization can be summarized as follows:

- Develop an ethical culture and working environment with high level of integrity in the organization;
- Develop mechanisms of perception and deterrence of potential offenders;
- Develop operational system of internal control;
- Integrate the internal audit function for an efficient anti-fraud process;
- Develop the initial education and anti-fraud training for employees.

3. Organizational anti-fraud culture

The first step in develop an effective system to prevent fraud in the organization is creating a strong culture of ethics and integrity throughout the organization.

Whatever the organizational structure of a company would be, managers and those charged with governance set the tone, a trend level of integrity and ethics in the organization. Known in the literature as "tone at the top" (Nettler, 1982), the term defines the involvement and attitudes of managers and others charged with governance to acts of fraud within the organization.

Anti-fraud culture development is an ongoing process, lasting for a long period of time, managers setting an example on attitudes towards fraud, communicate to employees the company's policy to acts of fraud and encourage any person involved in the fraud detection and deterrence.

Without the strong and intensive management support it is hard to believe that the organization can achieve a culture of integrity. The codes of ethics development is providing values and principles of integrity, is a symbol of the company's attitude towards fraud and should be adopted by all employees or third parties relational.

The connection between the fraud and the concept of setting the right tone at the top of the organization is revealing increasingly at international level.

Employees are paying increased attention to managers behaviour and actions and tend to follow their example. Whatever manifested principles and management behaviour, they will propagate down having effect on the company's employees. If the principles and behaviours by managers are supporting ideas of ethics and integrity, employees will be more inclined to support themselves these values. If senior management is not concerned with ethics, employees will be more likely to commit fraud because they feel that the integrity and ethical conduct are not basic principles and priorities of the organization.

It is essential for a company's success, for CEOs and all those charged with governance to set an example of ethical (or tone) for how their employees should behave at work. When those top positions are setting a wrong ethics policy by committing fraud, their employees will take heed and will walk in the footsteps of heads, creating an unethical workplace culture.

When managers put pressure on employees to meet unrealistic goals to produce profit for the company, actually forcing their employees to do whatever it takes to achieve these objectives, whether the way to achieve is abusive or not.

For setting the correct ethics principles, those in the top positions of management must follow four important steps: communicating to employees what is expected of them, exercising leadership by

example of his own company, providing a mechanism for safety and protection in reporting violations of rules, establish and provide rewards for ethics and integrity.

Determinants of ethical behaviour are represented by superiors, peers behaviour, ethical practices in the industry or sector of activity, the moral climate of society, the official policy of the company, the employees' loyalty to the company. All these factors must be addressed in building the organizational code of ethics.

According to studies conducted by the Centre for Ethics Resources in 2011, the managers' actions and attitude towards fraud and unethical behaviour in the workplace, influence significantly employees' behaviour. Thus, employees who feel that managers act in an ethical manner at work and have a positive attitude towards moral values (talking about the importance of business ethics, inform employees, keep their promises), will less commit fraud than employees who feel that managers only talk about the principles of ethics, without actually apply them and exemplify by their own behaviour. The study examines the variation of the four criteria: a) pressure on employees, b) the level of unethical behaviour at work, c) failure reporting on unethical and d) retail against whistleblowers in two contexts: that of a strong culture of ethics and a weak one.

The results show that in an organization with a high degree of ethical management, the pressure on employees (representing an important aspect of the fraud triangle) decreases by 75%, the unethical behaviour in the workplace decreases by 48%, reporting failure situations decreases by 38% and unethical behaviour on whistleblower retaliation are reduced 5 times (from 1 case of retaliation in 4 cases reported from 1 to 20).

Workmates behaviour influence the ethical conduct of a person, so that if an unethical behaviour is tolerated, new employees will certainly quickly adopt the same behaviour(in the opposite situation,

employees who observe ethical behaviour from their peers will be less inclined to commit misconduct).

Ethical practices in the industry are applied daily by employees at work. If in a particular industry is rooted some unethical practice and works like an unwritten law, employees will adapt to, as a standard or as an essential requirement in order to achieve the marketing objectives. The company's anti-fraud policy should provide clear descriptions about possible unethical practices to be encountered by employees and state the company's delimitation of such behaviour. If the company does not accept forms of fraud as bribery, influence peddling or illegal gratuities and combat all acts of fraud of this kind, it is unlikely that an employee will be influenced by practices in the market.

Official policy of the company is also a factor influencing the ethical behaviour of employees. An anti-fraud official policy means that the organization will publicly condemn unethical behaviour and will say moral misconduct will not be tolerated, regardless of their potential opportunity cost. This policy should be applied in practice and exemplified by the daily behaviour of persons in leadership so that employees are aware that anti-fraud policy is not only an apparent form adopted for maintaining the company's reputation, but an active mood in the workplace.

Another factor influencing the probability of an employee to commit fraud for or against the organization is *loyalty to the company*. Creating a work environment that feeds employee loyalty coincides with obtaining a positive work environment as defined by the AICPA in "Management Guidelines -Anti-fraud Programs and Controls: guidelines for prevention and deterrence of fraud". According to AICPA a negative work environment is characterized by unrecognized and unappreciated organizational performance, negative feedback for morality and personal integrity, unreasonable expectations about performance indicators,

uneven and unclear organizational responsibilities, poor communication methods and practices within the organization. In a negative work environment, employees' level of moral integrity and loyalty is low or nonexistent. This creates prerequisites for employees to commit fraud against the company, or for the company, but regardless of its consequences as it does not consider any obligation to protect the employing organization.

In a positive working environment characterized according AICPA as transparent by recognizing and rewarding performance, the correct application of the principle of equality of opportunity, encourage teamwork oriented processes and decision making collaborative system, employees will be reluctant to commit fraud that could affect the organization.

4. Framework tools for organizational anti-fraud culture development

The best way to implement measures to combat fraud is to establish a set of core values that are adopted by the entity. These values provide the framework structure of key principles to be guided by all the actions of employees.

Specific documentation drafting the anti-fraud strategy development contains the following types of documents: the anti-fraud company's policy, anti-fraud decision matrix, conflict of interest policy, code of conduct and business ethics.

The cornerstone of an effective anti-fraud is the ethical culture of the organization, and the values that are assumed and reflected in the code of conduct.

Anti-fraud policy (objectives and principles) and anti-fraud procedures (actions to achieve the objectives), are based on documents that will form the ethical culture of the organization and will be dealt with cases of fraud or suspected fraud. Anti-fraud policy of the company is the source from which are developed the prevention, detection and response measures, and major influences the effectiveness of anti-fraud strategy.

The Code of Ethical Conduct can be defined as a written reflection principles and rules / ethical rules governing individual and group human behaviour through documents known, accepted and assumed by members of an organization.

In the code of ethics, the organization expresses the opinion shared by the community to which it belongs and thus meet the requirement of communication, including the outside, its principles and rules of behaviour that has to boost the general principle of legality. A code of ethics that supports high values of professional conduct and moral integrity, will document aspects: fundamental ethical principles, general rules for employees (customer relations and quality assurance services or products), regulations and legal framework in preventing and combating money laundering and terrorist financing, regulations for the prevention, control and detection of fraud, the relationship with the state authorities, competition, advertising, equal opportunities, protection of the organization's assets, information protection, personal integrity issues, general regulations on conflicts of interest, rules of conduct at work, issues concerning the application of the Code, reporting of irregularities and possible disciplinary action.

Implementation of a Conflict of Interest Policy on conflicts of interest that may arise in the organization is a prerequisite for assuring the quality and transparency of decision-making processes and the company's activity and a way of effectively preventing any kind of economic fraud or corruption. A clear conflict of interest policy aims to establish a general framework for identifying and managing conflicts of interest in relation to all employees and managers with the organization, customers and business partners, including suppliers and authorities.

5. Conclusions

Developing an ethical culture and working environment with a high level of integrity in the organization, has the major advantage of preventing fraud acts, but it also represents a qualitative parameter by which potential investors assess the organization in making business decisions or prospective employees look forward to the company or not.

Positive impact on the organization's anti fraud strategy implementation, is demonstrated by reducing the probability of occurrence, detection time and materiality for fraud acts, however protecting corporate reputation, brand, management credibility, and the business itself.

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│ Step1: Objectives   │ →   │ Step 2: Team        │ →   │ Step 3: Fraud risk  │
│ and framework for   │     │ members in fraud    │     │ management          │
│ implementation      │     │ management          │     │                     │
└─────────────────────┘     └─────────────────────┘     └─────────────────────┘
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│ Step 4: Fraud       │ →   │ Step 5: Fraud       │ →   │ Step 6: Fraud       │
│ prevention system   │     │ detection system    │     │ investigation system│
└─────────────────────┘     └─────────────────────┘     └─────────────────────┘
         │
┌─────────────────────┐     ┌─────────────────────┐     ┌─────────────────────┐
│ Step 7: Fraud       │ →   │ Step 8:             │ →   │ Step 9: Quality     │
│ response and        │     │ Communication for   │     │ assessment for      │
│ deterrence system   │     │ antifraud strategy  │     │ antifraud strategy  │
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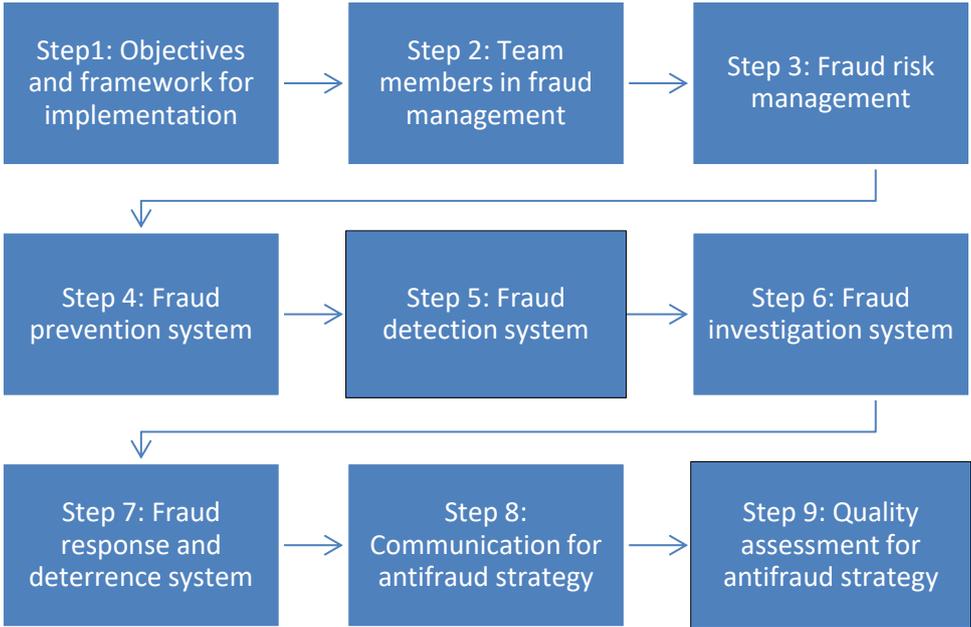
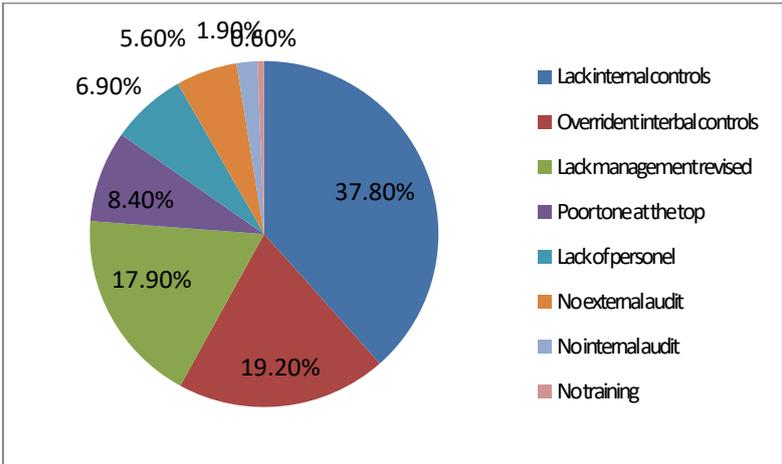*Figure No.1* Steps for anti-fraud strategy

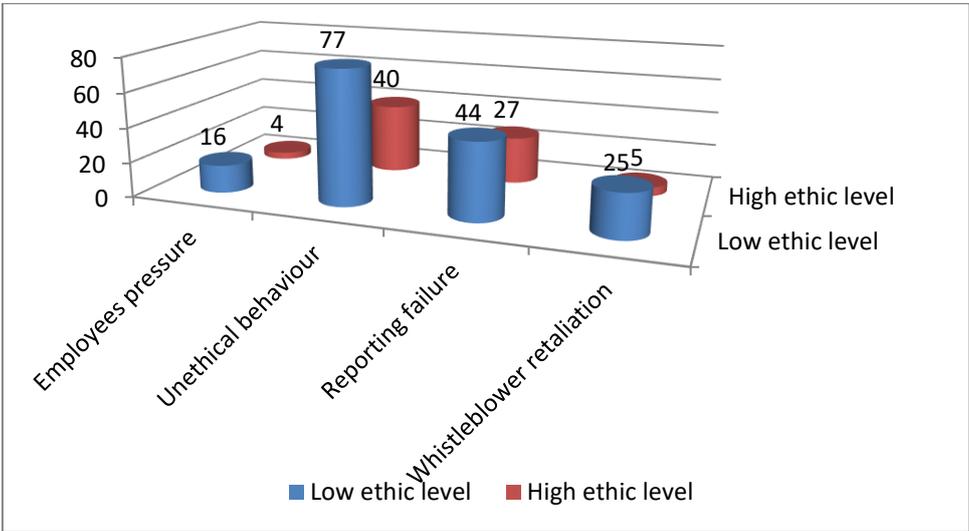*Figure No.2* Shortcomings in organizations that have been affected by fraud

Figure No.3 Management ethics culture level influence on workpl*ace*